

Message Text

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ACTION ARA-10

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TO SECSTATE WASHDC PRIORITY 5743

INFO AMEMBASSY QUITO

AMEMBASSY SANTIAGO

C O N F I D E N T I A L SECTION 1 OF 2 LIMA 5303

E.O. 11652: GDS

TAGS: EGEN, PINT, PE

SUBJECT: PRIME MINISTER PRESENTS ECONOMIC PACKAGE, CALLS
FOR PRODUCTIVITY, DENIES DEVALUATION POSSIBILITY

REFS: A. LIMA 5249

B. LIMA 5081

C. LIMA 4958

1. SUMMARY: DURING THREE-HOUR NATIONALLY-TELEVISED PRESENTATION, PRIME MINISTER MORALES BERMUDEZ OUTLINED GOP ECONOMIC PACKAGE TO LIMA PRESS CORPS. PACKAGE INCLUDED PUBLIC AND PRIVATE SECTOR WAGE INCREASES, PRICE INCREASES (FROM 10 PERCENT TO 35 PERCENT ON NUMEROUS ESSENTIAL PRODUCTS ON WHICH PRICES ARE CONTROLLED BY GOP). HE CATEGORICALLY DENIED POSSIBILITY OF DEVALUATION, AND CALLED SPECIFICALLY FOR GREATER INDUSTRIAL AND AGRICULTURAL PRODUCTION. HE MADE AN APPEAL TO LABOR IN ALL SECTORS FOR A "WORK CRUSADE". PRIME MINISTER BLAMED WORLD INFLATION FOR PROBLEMS AFFECTING GOP ECONOMIC STRATEGY BUT ALSO CANDIDLY ADMITTED THAT NATIONAL PRODUCTIVITY AND CONSEQUENTLY GOVERNMENT SAVINGS HAVE BEEN INSUFFICIENT. IN SIMILARLY CANDID
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MANNER, HE ALSO ADMITTED THAT GOVERNMENT SUBSIDY PROGRAM

HAD FAILED TO BENEFIT MASSES OF POPULATION AND THAT
GOP, FACED WITH INCREASING FOOD IMPORTS AND INCREASED
DEFICIT, DECIDED ON NEW MEASURES.

2. MORALES BERMUDEZ EMPHASIZED THAT PACKAGE OF MEASURES
WAS DESIGNED TO RATIONALIZE USE OF ECONOMIC RESOURCES
AND TO MAINTAIN PURCHASING POWER OF WORKERS WHILE ALIGN-
ING PRICES TO COSTS, THUS ENCOURAGING PRODUCTIVITY. IN
LONG QUESTION AND ANSWER SESSION FOLLOWING PRIME MINISTER'S
SPEECH, PRIME MINISTER FIELDERD QUESTIONS WITH AGILITY, AND
PASSED ON SPECIFIC RESPONSES TO OTHER "PRODUCTIVE SECTOR"
MINISTERS. IT SEEMS TO US THAT PRIME MINISTER'S STATURE
WAS SUBSTANTIALLY ENHANCED BY FIRM MANNER IN WHICH HE
DOMINATED PROCEEDINGS, AND BY HIS CALM AND COHERENT RES-
PONSES TO QUESTIONS. GENERAL TONE WAS VERY BUSINESS-LIKE
AND PRACTICALLY FREE OF DEMOGOGY AND PRIME MINISTER CER-
TAINLY EMERGED AS PRIMUS INTER PARES. PRICE INCREASES
COULD, HOWEVER, SPARK POPULAR DISCONTENT, PARTICULARLY
AMONG UNEMPLOYED AND UNDEREMPLOYED WHO STAND TO GAIN LITTLE
FROM WAGE INCREASES. END SUMMARY.

3. PERUVIAN ECONOMY BUFFETED BY INFLATION AND LACK OF
PRODUCTIVITY AND SAVINGS: MORALES BERMUDEZ BEGAN
PRESENTATION BY NOTING THAT SINCE FEBRUARY, GOP'S INTER-
MINISTERIAL COMMITTEE FOR FINANCIAL AND ECONOMIC AFFAIRS
(CIAEF) HAS BEEN CLOSELY MONITORING QUESTIONS OF IN-
FLATIONARY PRESSURES, SUBSIDIES, AND SUPPLIES. FIRST,
PERU HAS BEEN AFFECTED BY EXTERNAL INFLATIONARY PRESSURES
WHICH LED TO PRICE DISTORTIONS, FOREIGN EXCHANGE DRAIN
FOR FOOD IMPORTS, AND SUBSEQUENT REDUCTION IN PUBLIC SAV-
INGS, PRESSURE ON GOP BUDGETARY RESOURCES, AND CONTRA-
BAND SALES OF SUBSIDIZED FOODS TO NEIGHBORING COUNTRIES.
THUS, GOP DECIDED ADOPT NEW INTEGRATED AND GRADUAL SOLU-
TION, READJUSTING PRICES ON BASIC COMMODITIES, INCLUDING
FOOD, FUEL, TRANSPORT AND FERTILIZERS (WHICH WILL CONTINUE
TO BE SUBSIDIZED TO INCREASE AGRICULTURAL PRODUCTION). AFTER
PRICE ADJUSTMENTS, A PRICE FREEZE WILL BE IMPOSED TO ALLOW GOP
TIME TO STUDY EFFECTS.

4. PUBLIC AND PRIVATE SECTOR WAGE INCREASES: PUBLIC SECTOR
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WORKERS ARE TO RECEIVE WAGE INCREASES OF S/.1,600 MONTHLY
ACROSS-THE-BOARD. IN ADDITION, THOSE PUBLIC AND PRIVATE
SECTOR WORKERS SUBJECT TO GENERAL LABOR LAWS, WHICH COVER
A NUMBER OF STATE ENTITIES, WILL RECEIVE INCREASE OF S/.400
MONTHLY. FOR THE PRIVATE SECTOR, DECREE LAW 21202 SETS
FORTH GUIDELINES FOR COLLECTIVE BARGAINING DURING
REST OF
1975: (A) MINIMUM GENERAL INCREASE: S/.450 MONTHLY OR

S/.15 DAILY; (B) MAXIMUM GENERAL INCREASE: S/.1,620 MONTHLY OR S/.54 DAILY. IN LATTER CASE, WHEN ECONOMIC CONDITION OF FIRM SO PERMITS, INCREASES TO S/.2,100 MONTHLY, OR S/.70 WILL BE APPROVED. SAME D.L. ALSO ESTABLISHES CEILING ON NEW SALARY CONTRACTS IN THE PRIVATE SECTOR OF S/.840,000 YEARLY, OR S/.70,000 MONTHLY FOR NEW EXECUTIVES (EXISTING CONTRACTS ARE APPARENTLY UNAFFECTED). WAGES BEYOND THIS LIMIT WILL NOT BE CONSIDERED A COST TO THE FIRM, BUT MUST RATHER BE SUBTRACTED FROM PROFITS REMAINING AFTER THE INDUSTRIAL COMMUNITY HAS RECEIVED ITS SHARE. (COMMENT: THIS LIMIT COULD PLACE SERIOUS CRIMP IN ATTRACTING COMPETENT MANAGERS AND TECHNICIANS, BOTH PERUVIAN AND FOREIGN, TO MANAGE AND ADVISE PRIVATE SECTOR ENTERPRISES.) D.L. 21207 OF JUNE 26 ALSO RAISED MINIMUM SALARIES FOR THIRTEEN DEPARTMENTS OF PERU, INCLUDING LIMA. LIMA MINIMUM INCREASED FROM S/.3,000 TO S/.3,540.

5. PRIME MINISTER NOTED THAT BASIC PRIVATE AND PUBLIC SECTOR INCREASES WERE JUSTIFIED ON BASIS OF PREVIOUS INFLATION RATES, AND THAT S/.400 ACROSS-THE-BOARD INCREASE WAS CALCULATED ON BASIS OF A THEORETICAL MINIMUM SALARY OF S/.4,000. PRIME MINISTER THEREFORE IMPLIED THAT PRICE INCREASES WILL PROBABLY BE AT LEAST TEN PERCENT, THE FIGURE HE SAID GOP HAD TAKEN AS BASIS FOR ARRIVING AT S/.400 FIGURE TO COMPENSATE FOR PRICE INCREASES PROMULGATED BY GOP.

6. FUEL INCREASES AND PETROLEUM PROSPECTS: PRICES OF 84 AND 95 OCTANE GASOLINE JUMPED TO S/.15 (67 PERCENT INCREASE) AND S/.30 (100 PERCENT) A GALLON, RESPECTIVELY. PRIME MINISTER POINTED OUT THAT PETROPERU HAS BEEN RUNNING A DEFICIT, AND IT IS NECESSARY TO ELIMINATE SUBSIDIES ON THESE PRODUCTS. NEITHER HE NOR MINES MINISTER FERNANDEZ

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MALDONADO RESPONDED DIRECTLY TO QUESTION WHETHER FULL COST OF GASOLINE PRODUCTS WILL BE MET BY NEW PRICE INCREASES. BOTH MINISTERS, HOWEVER, STATED THAT PERU'S FIRST PRIORITY IN PETROLEUM FIELD IS TO BECOME SELF-SUFFICIENT BY 1977 WHEN NORTH-ANDEAN PIPELINE WILL BE COMPLETED, AND THEN, EVENTUALLY, TO BECOME PETROLEUM EXPORTER. BOTH ALSO SAID THERE HAS BEEN AN "INTERNATIONAL CAMPAIGN" AGAINST PERU'S OIL PROGRAM, DESIGNED TO REDUCE COUNTRY'S PRESTIGE BY CLAIMING THERE IS LITTLE PETROLEUM IN THE JUNGLE. (COMMENT: MINISTER'S STATEMENTS ARE FIRST MAJOR PUBLIC ADMISSION THAT PIPELINE WILL NOT BE FINISHED UNTIL 1977 AND THAT PERU'S PETROLEUM PROSPECTS ARE NOT YET BRIGHT ENOUGH TO EXPECT PERU TO BECOME PETROLEUM EXPORTER IMMEDIATELY UPON COMPLETION OF THE PIPELINE. WE PRESUME ATTACK ON "FOREIGN NAY-SAYERS" REFERS INTER ALIA TO MAY 26 OIL AND GAS JOURNAL

ARTICLE (POUCHED TO ARA/EP.)

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C O N F I D E N T I A L SECTION 2 OF 2 LIMA 5303

7. AGRICULTURAL POLICY; PRIME MINISTER LAID CONSIDER-
ABLE STRESS ON LACK OF SUFFICIENT AGRICULTURAL PRO-
DUCTIVITY, WHICH HE ADMITTED HAS ACTUALLY FALLEN SINCE
THE AGRARIAN REFORM WAS INSTITUTED. HE SAID THAT, GIVEN
LACK OF PRICE INCENTIVES TO AGRICULTURAL PRODUCERS, PRO-
DUCTION HAS DROPPED OFF. THUS, IN AN EXCEPTION TO
GENERAL DECISION TO REDUCE SUBSIDIES, SUBSIDIES WILL BE
PLACED ON FERTILIZERS TO INCREASE INCENTIVES FOR FAR-
MERS TO PRODUCE MORE AND ACTUAL COST WILL GO DOWN BY 40
PERCENT. HE THEN CALLED FOR A "WORK CRUSADE", PARTICU-
LARLY IN AGRICULTURE. FOOD MINISTER HOYOS ALSO SAID
THAT HIS MINISTRY IS WORKING ON MEANS TO REDUCE ROLE OF
MIDDLEMEN IN FOOD-PROCESSING CHAIN, AND PLANS TO COORDI-
NATE WITH REGIONAL OFFICES OF HIS MINISTRY AND LOCAL
AUTHORITIES TO PURCHASE SPECIFIC FOOD PRODUCTS DIRECTLY
FROM PRODUCER FOR SALE TO THE CONSUMER. HE ADMITTED,
HOWEVER, THAT SOME FORMS OF CAPITALISM WILL CONTINUE TO
EXIST IN PERU AND THAT IT WILL NOT BE IMMEDIATELY POSSIBLE
TO ELIMINATE MIDDLEMEN ENTIRELY.

8. PRICE LEVELS: FINANCE MINISTER VARGAS GABILANO SAID
THAT GOP NOW EXPECTS INFLATION RATE TO RUN TO ABOUT 30
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PERCENT THIS YEAR (INCLUDING NEW PRICE INCREASES), BUT
THAT INFLATION RATE FOR FULL FOUR-YEAR TERM OF NATIONAL
DEVELOPMENT PLAN (1975-78) SHOULD DROP OFF TO 20 PERCENT
ANNUALLY. PRIME MINISTER ALSO EMPHASIZED THAT AFTER
PRICE AND WAGE INCREASES GO INTO EFFECT, RATE OF
PRICE RISE SHOULD BEGIN TO TAPER OFF.

9. UNDEREMPLOYMENT AND UNEMPLOYMENT. TWO RADICAL
JOURNALISTS, HUGO NEIRA OF "CORREO" AND PACO MONCLOA
OF "EXPRESO", PRESSED MINISTERS HARD ON EFFECTS OF
PRICE INCREASES ON THE UNDEREMPLOYED AND UNEMPLOYED. PRIME
MINISTER GAVE INDIRECT ANSWER THAT UNDEREMPLOYMENT AND
UNEMPLOYMENT ARE STRUCTURAL PHENOMENA OF ALL LDCS AND
THAT BASIC CHANGES BROUGHT ABOUT BY GOP ARE INCREASING
REDISTRIBUTION OF INCOME AND THEREFORE OF BUYING POWER
OF WORKERS GENERALLY. (COMMENT: NEIRA'S QUESTION
CAUSED THE PRIME MINISTER HIS ONLY MOMENT OF VISIBLE
UNEASE AND HE RETORTED SHARPLY. NEIRA ALSO HAS A POINT,
SINCE UNORGANIZED WORKERS ARE THOSE WHICH WILL PROBABLY
SUFFER MOST FROM PRICE HIKES, WITHOUT RECEIVING FULL
BENEFIT OF WAGE INCREASES.)

10. REDUCTION OF SUBSIDIES: FINANCE MINISTER VARGAS
GAVILANO ALSO RESPONDED TO QUESTION ABOUT SUBSIDIES,
NOTING THAT DIRECT SUBSIDIES PROGRAMMED FOR 1975-76
AMOUNTED TO S/.11.8 BILLION, WHICH WILL BE REDUCED TO
S/.3.8 BILLION DURING BIENNIUM FOR A SAVINGS OF S/.8
BILLION. (COMMENT: THIS SAVING REPRESENTS ONE-QUARTER OF PROGRAMMED
GOP BIENNIAL DEFICIT, AND FIRS CLOSELY
WITH COMMENTS OF IMF REPRESENTATIVE (REF B)
THAT SAVINGS FROM DEFICIT WILL PROBABLY NOT BE SUFFI-
CIENT TO GENERATE SUBSTANTIAL GOVERNMENT INVESTMENT
THAT GOP HAS ORIGINALLY HOPED FOR.)

11. NO DEVALUATION: PRIME MINISTER EMPHASIZED IN
HIS SPEECH THAT DEVALUATION IS TOTALLY OUT OF THE QUES-
TION AND THEN CITED NUMEROUS REASONS, INCLUDING INELAS-
TIC EXPORTS, CONTROLLED IMPORTS, AND PRICE CONTROLS AS
REASIVEALUE (SEE LIMA 4658). (COMMENT:
WHILE GOVERNMENTS REARELY ANNOUNCE DEVALUATIONS BEFORE-
HAND, THE CATEGORICAL MANNER IN WHICH PRIME MINISTER
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REJECTED DEVALUATION AS POSSIBILITY SHOULD REDUCE
RUMORS THAT GOP IS ACTIVELY CONSIDERING SUCH A MEASURE AT THIS TIME).

12. CARTELS: IN RESPONSE TO QUESTION, MINES MINISTER
FERNANDEZ MALDONADO LAUDED PERU'S SUPPORT FOR RAW MATERIALS
CARTELS, CLAIMED THAT CIPEC WILL SOON EXPAND MEMBERSHIP
TO INCLUDE VARIOUS ASIAN NATIONS, AND THAT PERU IS ACTIVE
IN MERCURY CARTEL AND WILL BE DISCUSSING SILVER CARTEL
WITH MEXICAN DELEGATION DUE TO VISIT LIMA THIS MONTH.
MINISTER SAID THAT PERU SHOULD "IMPOSE JUST PRICES" THROUGH
CARTELS ON INDUSTRIALIZED WORLD AND PRAISED PERUVIAN IN-
ITIATIVE AT HAVANA NONALIGNED COORDINATING MEETING EARLIER
THIS YEAR TO WORK FOR A WORLD-WIDE RAW MATERIALS PRODUCERS
ASSOCIATION. FERNANDEZ MALDONADO SAID THAT RESOLUTION
EIGHT OF THE HAVANA CONFERENCE ON THIS SUBJECT WILL BE
SPONSORED BY PERU DURING FORTHCOMING NONALIGNED CONFERENCE
IN LIMA IN MID-AUGUST. COMMERCE MINISTER ARIAS GRAZIANI
ALSO MENTIONED THAT PERU WILL CONSULT WITH OTHER LATINS
ON POSSIBILITY OF MAINTAINING JUST PRICE FOR SUGAR AND
IS WORKING WITH EGYPT AND THE SUDAN TO STUDY POSSIBILI-
TIES OF A COTTON CARTEL FOR THE KINDS OF COTTON (LONG
STAPLE) THE THREE COUNTRIES PRODUCE. (COMMENT: MENTION
OF CARTEL POLICY FOLLOWED STANDARD GOP RHETORIC, AND WAS
ONLY MOMENT WHICH VERGED ON DEMAGOGY. PRIME MINISTER
TURNED CARTEL QUESTION OVER TO MINES MINISTER IMMEDIATELY.
AND DID NOT SEEM PARTICULARLY INTERESTED IN SPEAKING TO
THIS ISSUE HIMSELF.)

13. OTHER MEASURES: FINANCE MINISTER VARGAS GAVILANO
SEVERAL TIMES EMPHASIZED NEED TO INCREASE NATIONAL SAV-
INGS, BUT MADE NO MENTION OF CHANGING INTEREST RATES
WHICH HAVE BECOME HIGHLY NEGATIVE IN REAL TERMS. MINISTER
SAID THAT NEW TAXES ARE UNDER STUDY AND WILL BE IMPOSED
IN THE FUTURE, BUT NOT IMMEDIATELY, SINCE GOP NEEDS TO
EVALUATE EFFECTS OF WAGE/PRICE PACKAGE BEFORE INTRODUCING
SUCH MEASURES. (COMMENT: IT IS NOT CLEAR HOW THE GOP
INTENDS TO PROCEED IN THIS AREA. ON THE BASIS OF THE
PROGRAM AS DISCUSSED, IT APPEARS THAT HIGHER SAVINGS WILL
RESULT ONLY FROM THE ELIMINATION OF SUBSIDIES, AND PER-
HAPS DECREASED CONSUMPTION.)

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QRM COMMENT: PRIME MINISTER MORALES BERMUDEZ CLEARLY
STOOD OUT AMONG HIS COLLEAGUES LAST NIGHT AT THE FIRST
AMONG EQUALS, IF NOT QUITE YET THE ACTING PRESIDENT OF PERU.
ONLY ONE MINISTER AND A COUPLE OF JOURNALISTS EVEN
MENTIONED PRESIDENT VELASCO'S NAME, AND IT WAS CLEAR
TO ALL THAT MORALES BERMUDEZ WAS IN THE DRIVER'S SEAT.

SEVERAL WELL-INFORMED TECHNICIANS HAD TOLD US EARLIER THAT THE GOP HAD HOPED THAT PRESIDENT WOULD BE ABLE TO MAKE THE "ECONOMIC POLICY PACKAGE" PRESENTATION, BUT IS NOW APPEARS THAT HIS HEALTH DID NOT PERMIT HIM TO DO SO. IN THE EYES OF THE PUBLIC, THESE MEASURES ARE CLEARLY IDENTIFIED WITH THE PRIME MINISTER, WHO THROUGH HIS UNDERSTANDING OF ECONOMICS AND THE FORCE OF HIS PERSONALITY HAS BROUGHT ABOUT A FUNDAMENTAL CHANGE IN DOMESTIC ECONOMIC POLICY. TO US, THE PRIME MINISTER'S OPEN ADMISSION THAT PERU'S PAST POLICIES HAVE NOT MET THEIR GOALS WAS A REFRESHING DEPARTURE FROM THE USUAL GOP VERBIAGE. WHILE MORALES BERMUDEZ ADMITTED THAT WORLD INFLATION IS A PARTIAL CAUSE OF PERU'S TROUBLES, HE DID NOT CASTIGATE THE CAPITALIST WEST, BUT CENTERED HIS ATTENTION ON PERU'S LACK OF INCENTIVES FOR PRODUCTIVITY, AND MENTIONED SEVERAL TIMES THAT PERUVIANS THEMSELVES WILL BE RESPONSIBLE FOR THE FUTURE ECONOMIC COURSE OF EVENTS. HE THEREFORE CALLED FOR A "WORK CRUSADE", BUT STOPPED FAR SHORT OF ANNOUNCING THE NEED FOR A "NEW PERUVIAN MAN" WHO WOULD WORK SOLELY OR PRINCIPALLY FOR MORAL INCENTIVES ALONE.

15. THE MINISTERS' PRESENTATION LEFT MUCH TO BE DESIRED IN THE WAY OF HARD ECONOMIC FACTS WHICH WOULD PERMIT US TO CALCULATE WITH REASONABLE ACCURACY THE INCIDENCE OF PRICE INCREASES WHICH THE PACKAGE WILL BRING IN ITS WAKE. ACCORDING TO THE MINISTERS' STATEMENTS, THEY APPARENTLY ESTIMATE THAT PRICE INCREASES WILL PUSH INFLATION THIS YEAR FROM TWENTY PERCENT TO APPROXIMATELY THIRTY PERCENT. WE TEND TO THINK THAT PRICE INCREASES COULD GENERATE SUBSTANTIALLY MORE INFLATION, AT LEAST FIFTEEN PERCENT AND POSSIBLY TWENTY PERCENT OR MORE, DEPENDING ON THE MULTIPLIER EFFECT. IT IS THEREFORE POSSIBLE THAT INFLATION THIS YEAR COULD REACH FORTY PERCENT OR MORE, BUT IT IS TOO EARLY TO PREDICT WITH ACCURACY.

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IN ANY CASE, PERU HAS NOW ADOPTED THE "MORALES BERMUDEZ FORMULA" AND HE IS CLEARLY THE TARGET FOR ANY FUTURE AGITATION WHICH COULD WELL DEVELOP WHEN THE EFFECTS OF PRICE INCREASES BEGIN TO BE FELT AMONG THE GENERAL URBAN POPULATION. HIS EMPHASIS ON FLEXIBILITY, HOWEVER, COULD STAND HIM IN GOOD STEAD, AND SHOULD WIDE-SPREAD POPULACE DISCONTENT DEVELOP, IT IS POSSIBLE THAT THE GOP WOULD CONSIDER FURTHER REMEDIAL MEASURES ON THE WAGE SIDE, EVEN THOUGH THIS MIGHT MEAN SOME LONG-RANGE REDUCTION IN THE COUNTRY'S DEVELOPMENT PROJECTS.

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